

Compliance Alert - Food Vendors Neglecting to Collect Illinois Sales Tax on Sales of Ready-Made Meals for School Lunch Programs



October 2019

Compliance Problem

The Illinois Department of Revenue (IDOR) is aware that some food vendors are failing to properly remit Retailers' Occupation Tax ("sales tax") on sales of food to schools and parent-teacher organizations (PTOs) that is resold to students during lunch periods. IDOR is also aware that some food vendors are failing to properly remit sales tax on sales of food made directly to students. These vendors also are giving erroneous advice to schools or PTOs, causing the schools or PTOs to potentially misuse (and risk losing) their sales tax exempt status.

IDOR has identified the following predominant methods that schools utilize to provide lunches to students when the schools do not have the facilities or staff to provide the lunches themselves:

1. A third-party vendor makes sales directly to students, often with a percentage of the proceeds being donated to the school or PTO. In this scenario, students or parents select from a range of food options and submit their orders and payment to the vendor, sometimes with the school or PTO facilitating the sales as an intermediary.
2. A third-party vendor makes bulk sales of prepared meals for students to the school, and the school then resells the meals to students. In this scenario, students do not submit orders or payment directly to the vendor. The school conducts the sale using school staff or further contracts for labor in dispensing the meals.
3. A third-party vendor makes sales of prepared meals for students to a PTO, and the PTO then resells the meals to students. Again, in this scenario, students do not submit orders or payment directly to the vendor. The PTO conducts the sale.

Background

Organizations that make application to IDOR and are determined to be exclusively religious, educational, or charitable receive an Illinois exemption identification ("E") number. 86 Ill. Adm. Code 130.2007. This E number evidences that IDOR recognizes the organizations as exempt from incurring Use Tax when purchasing tangible personal property in furtherance of their organizational purposes. If an organization does not have an E number, then its purchases are subject to tax. Only sales to organizations holding an E number are exempt, not sales to individual members of the organization. A PTO may qualify to receive an E number as a charitable organization. A school may qualify for an E number as an institution organized and operated exclusively for educational purposes under Section 2h of the Retailers' Occupation Tax Act.

Organizations that possess active E numbers are also allowed to engage in a very limited amount of retail selling without incurring sales tax liability. An exempt organization may engage in sales to members, noncompetitive sales, and certain occasional dinners and similar activities (no more than two times a year) without incurring sales tax liability. See 86 Ill. Adm. Code 130.2005(a)(2) through (a)(4).

Special rules apply to dining facilities operated by schools. A school does not incur sales tax liability on its operation of a cafeteria or other dining facility if it is conducted on the school's premises and is confined to sales to the students and employees of the school. In any instance in which the dining facility is opened up for the use of other persons, all sales that are made at such facility, until such time as the facility reverts back to use strictly by that school's students and employees, are taxable. A school making tax-exempt purchases of food must provide an active E number to the vendor at the time of purchase. See 86 Ill. Adm. Code 130-2005(b)(4)(A).

Background (cont.)

Charitable or religious organizations, such as PTOs, incur sales tax liability on their receipts from sales of meals, unless such selling constitutes an occasional dinner or other similar activity. No more than two such occasional dinners or other similar activities are authorized in any calendar year. See 86 Ill. Adm. Code 130.2005(b)(4)(B). Because some schools lack kitchen facilities necessary to prepare meals for their students, PTOs may contract with food vendors to provide ready-made meals (*e.g.*, bag lunches or hot meals) that the PTO resells to students at the school. Except for the two occasional dinners, a PTO cannot sell meals to students tax-free.

Food vendors that sell meals to students and not the school incur sales tax liability on meals purchased by the students. The fact that a school permits the food vendor to sell meals to the students or may collect the cost of the meals from the students and remit the money to the food vendor does not change the food vendor's tax liability. For the sales to be tax-exempt, the sales must be made to the school.

Solution

- Food vendors making sales of meals directly to students must charge tax on the full amount of the sales. Any percentage of the proceeds that is donated to the school or PTO is still taxable. Vendors cannot rely on the exempt status of the schools or PTOs acting as intermediaries to avoid having to collect tax on these sales.
- Food vendors making sales of previously prepared meals to schools that are resold by the schools to their students do not incur sales tax liability, provided the schools provide their E number to the food vendors. 86 Ill. Adm. Code 130.2005(d). The schools are the seller in this scenario; the vendor only acts as a supplier. As explained in the "Background" section of this Compliance Alert, schools may make tax-free sales of meals to students, provided that selling is conducted on the school's premises and is confined to students and employees of the school.
- PTOs engaging in sales to students must register with IDOR as a retailer and then collect and remit tax on those sales. The PTO must provide a food vendor with Form CRT-61, Certificate of Resale to be allowed to make tax-free purchases of those meals. PTOs cannot use an E number to purchase the meals tax free because the purchases are not for their use. Neither can a PTO rely on the two occasional dinners exception for fundraising activities for all its lunch sales to students. Each day the PTO offers meals for sale to students counts as one of the two occasional dinners. If the vendor does not receive a resale certificate from the PTO, it must collect tax from the PTO and remit sales tax to IDOR. A vendor that fails to remit the tax is liable for the tax on its sale to the PTO. The PTO remains liable for sales tax on the sale to the students. While it may receive a credit for taxes paid to the vendor, it remains liable for applicable local taxes, as well as penalties and interest.

An exempt organization that improperly purchases or sells tangible personal property tax-free or that allows other organizations to improperly use its E number risks having IDOR revoke its E number.

Questions

If you have questions regarding this compliance alert, please email Rev.ComplianceAlerts@illinois.gov.